REDACTED VERSION

STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 99-155

August 2, 1999

CENTRAL MAINE POWER COMPANY
Annual Price Change Pursuant
to the Alternative Rate Plan

ORDER ON ISSUE OF PROCEEDS
FROM SALES OF CMP EASEMENTS
TO GAS PIPELINE COMPANIES

WELCH, Chairman; NUGENT and DIAMOND, Commissioners

I. SUMMARY

This Order addresses the ratemaking treatment of proceeds from Central Maine Power Company's sale of easements to Portland Natural Gas Transmission System (PNGTS) and Maritimes and Northeast Pipeline, L.L.C. (Maritimes). We find that ratepayers bear and have borne the risk of loss on the land over which the rights of way are granted and have shouldered significant economic burdens associated with the land. We further find that the transmission corridors over which the rights of way are granted were generally created through the use of, or under the threat of, eminent domain power. In these circumstances, we conclude that ratepayers are entitled to the proceeds from the sale of the rights of way to gas pipeline companies. We allocate 90% of these proceeds to ratepayers and 10% to shareholders. We further determine that the ratepayer portion of the proceeds should be amortized over a 5-year period beginning at the time of the closing of each transaction.

II. PROCEDURAL HISTORY

On March 15, 1999, Central Maine Power Company(CMP) made its annual filing pursuant to the Alternative Rate Plan (ARP) approved by the Commission in its Order dated January 10, 1994 in Phase II of Docket No. 92-345. The Hearing Examiner issued a notice of proceeding on March 25, 1999. Initially, the Public Advocate and the Industrial Energy Consumers Group (IECG) intervened in this matter. The Commission held a case conference on April 8, 1999. At that conference, the Commission Advisory Staff (Advisors) suggested that the issue of transmission and distribution marginal cost floors and adders for pricing flexibility contracts that extend beyond February 29, 2000, be considered in this case. There were no objections from the parties to consideration of this issue. A supplemental notice was issued and as a result, BOC intervened in this case.

The Advisors and the Public Advocate conducted discovery, and the Commission held two technical conferences. The Public Advocate and the IECG filed comments by May 14, 1999. At the second technical conference, it was decided that the ratemaking treatment of proceeds from the sale of easements to gas pipeline companies in 1998 and 1999 would proceed on a different track from the other issues because it was the only matter not amenable to settlement. CMP filed a partial stipulation between it and the Public Advocate on June 17, 1999 resolving the other issues, and the Commission approved that resolution at its deliberative session on July 1, 1999. *Central Maine Power Company, Annual Price Change Pursuant to Alternative Rate, Docket No. 99-135, Order (July 13, 1999).*

Pursuant to an agreed upon schedule, the Advisors issued a Bench Analysis and parties filed briefs on the easement issue. The Commission deliberated the matter on June 21, 1999.

III. FACTUAL BACKGROUND

In September of 1998, CMP entered into an easement agreement with the Portland Natural Gas Transmission System (PNGTS). CMP and PNGTS entered into the easement agreement pursuant to an order of condemnation issued by the United States District Court for the District of Maine. The order grants PNGTS a perpetual easement to:

> prepare, lay, install, construct, maintain, operate, replace, repair, change the size of, alter, abandon, remove and conform to any applicable federal, state or local requirements a single natural gas transmission pipeline and all related equipment and appurtenances thereto (including but not limited to meters, fittings, tie overs, valves, pipeline communications and data collection systems, regulators and pig launchers and receivers) ("the Pipeline"), and such additional rights as are incidental to the preparation, construction, repair, operation and maintenance of the pipeline as authorized by PNGTS's certificates of public convenience and necessity or orders issued by the Federal Energy Regulatory Commission ("FERC") or as required by the U.S. Department of Transportation regulations at 49 C.F.R. Part 192 ("Certificates"), under, over and across [certain] portions of the CMP electric transmission line system corridors ("Corridors") . . . .

Description of Easement Rights Taken by Portland Natural Gas Transmission System and Maritimes & Northeast Pipeline, L.L.C. with Respect to Lands and Held by Central Maine Power Company. The agreement provides for a one-time payment. CMP represents that it recorded **[CONFIDENTIAL BEGINS CONFIDENTIAL ENDS]** on its sale of this easement to PNGTS. CMP did not petition for authorization to sell the easement to PNGTS, pursuant to 35-A M.R.S.A § 1101, because the sale was pursuant to an order of condemnation by the federal district court.

In 1999, CMP entered into a Grant of Easement and Consent and Right of Way Use Agreement with Maritimes and Northeast Pipeline, L.L.C., (Maritimes). In the Right of Way Agreement, CMP grants to Maritimes "the exclusive right to occupy and use the Exclusive Use Zone of the Maritimes Easement for the purposes and with the facilities authorized in the Easement and Consent." The Exclusive Use Zone is defined as :

> the surface, subsurface and air rights (such air rights are limited to restricting above-ground structures) of land, which are within 15 feet from the vertical center line plane of Maritimes' natural gas interstate transmission pipe ("Pipe").

Maritimes Agreement ¶1(a).

The Commission authorized CMP and Maine Electric Power Company (MEPCO)[1] to sell easements and consents along CMP's and MEPCO's transmission corridors to Maritimes for the purpose of building natural gas transmission pipelines and appurtenant structures. *Central Maine Power Company, Request for Approval of Transfer of Assets Application for Authorization to Sell Easements and Consents for Natural Gas Transmission Lines,* Docket No. 98-079, Order (July 14, 1998). The parties to Docket No. 98-079 had agreed that the Commission should authorize the sales subject to certain conditions including the reservation of the ratemaking treatment of the proceeds for a future proceeding.

The Commission described the conveyance as follows:

> The conveyances from CMP to M&N involve 26.3 miles of CMP [transmission] corridors and 47.6 miles of laterals along CMP lines in Cousins Island, Skowhegan and Bucksport, as well as 47.8 miles of MEPCO corridors and 41.8 miles for laterals in Millinocket along MEPCO lines. M&N has proposed alternative mainline routes to the FERC. The agreed-upon consideration will be based the final mileage actually used by M&N.

Id. at 1. CMP represents that the revenues from the Maritimes transactions are **[CONFIDENTIAL BEGINS CONFIDENTIAL ENDS]**.

[1]CMP owns 78.3% of MEPCO

IV. ANALYSIS AND DECISION

A. Positions Before the Commission

The Bench Analysis recommended that 90% of the gains from the sale of the easements be allocated to ratepayers and 10% to shareholders and that the gains be amortized over a 5-year period beginning in 1998 for the PNGTS revenues and 1999 for the Maritimes and Northeast Pipeline revenues. The Bench Analysis concluded that ratepayers are entitled to the gain from the proceeds of the easement sales because ratepayers had borne the risk of decreases in the value of the transmission corridors and had also shouldered the economic burdens associated with these corridors. The purpose of the 10% allocation recommended in the Bench Analysis was to create an incentive for CMP to negotiate for the highest possible price in any future transactions of a similar nature. In recommending the 5-year amortization, the Bench Analysis adopted a ratemaking treatment and time frame that had been found to be reasonable in other similar land transactions. *See e.g., Standish Telephone Company, Request for Commission Approval or Determination that Approval Is Not Required for Transfer of Land and Building*, Docket No. 88-21, Order Approving Stipulation (Sept. 1988); *Re Boston Gas*, 174 PUR 4th 200, 262 (Mass. DPU 1996).

CMP maintained that shareholders are entitled to the proceeds from CMP's sale of easements to gas pipeline companies. CMP argued that under Maine law, shareholders receive the gain and suffer the loss when nondepreciable property is sold. CMP based its claim on *Maine Water Co. v. Public Utilities Commission*, 482 A.2d 443 (Me. 1984). CMP also argued that under the terms of CMP's Alternative Rate Plan (ARP), CMP's shareholders are entitled to the proceeds from these sales.[2]

The Public Advocate agreed with the Bench Analysis's determination that ratepayers are entitled to the gain on the sale of easements to gas pipeline companies. Specifically, it supported the conclusion that ratepayers have borne the economic burdens relating to the assets and the risks of loss on these assets and that the allocation of a gain on the sale of utility assets should not be based on a distinction between depreciable and nondepreciable property. The Public Advocate disagreed with the recommended allocation of 10% of the proceeds from the sale to shareholders as an incentive. This incentive is unnecessary because, in the Public Advocate’s view, it is unlikely that CMP will engage in further negotiations for gas pipeline easements. The Public Advocate also argued that the revenues may be considered as exogenous under the ARP, but did not object to the recommendation of the 5-year amortization period.

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[2]Since 1994, CMP has been operating under an Alternative Rate Plan (ARP). The ARP stipulation, approved by the Commission, provides for annual reviews to determine a number of issues. In this annual review case, CMP had accounted for the revenues from the PNGTS transaction by “recognizing” them in their computation of Return on Equity Calculation for Profit Sharing Mechanism contained in Attachment 4, page 1. The 1999 revenues from Maritimes would, under CMP’s proposal, be booked in a similar fashion. Because the revenues would not bring CMP into earnings sharing in 1998, shareholders would retain the benefit of the gain under CMP’s filing.

The IECG supported both the reasoning and recommended resolution set forth in the Bench Analysis but stressed the public policy considerations flowing from the nature of assets at issue. Because the transmission corridors were created either through the use of, or under the threat of, eminent domain power, they represent an imposition of governmental authority upon individual citizens which is justified by the greater public benefit associated with the provision of utility service. However, because of the public nature of both the benefit and detriments associated with these assets, the benefit should be returned to the public through a credit against utility revenue requirements. The IECG stated that although CMP investors should continue to be compensated through regulated rates of return for assets such as the transmission corridors which are held in rate base, "they are not entitled to monopoly rents as land speculators in the public property they have acquired through use or threat of eminent domain to serve the public convenience and necessity."

B. Risk/Burden Analysis

In *Democratic Central Committee v. Washington Metropolitan Transit District*, 485 F.2d 786 (D.C. Cir. 1973), cert. denied, 415 U.S. 935 (1974), the D.C. Circuit Court of Appeals developed an analytical framework for determining whether ratepayers or shareholders should receive the gain of the sale of utility property. Below we examine the *Democratic Central* analysis and discuss case law from Maine and other jurisdictions.

1. Democratic Central Committee v. Washington Metropolitan Transit District

The leading case on the ratemaking treatment of gains on the sale of utility property is *Democratic Central Committee v. Washington Metropolitan Transit District,* 485 F.2d 786 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 935 (1974). In that case, the D.C. Circuit Court of Appeals held that ratepayers should be entitled to the gain on the sale of both depreciable and nondepreciable property because they had borne the economic burdens associated with such property.

In determining that the Washington, D.C. Transit Commission had erred in refusing to credit ratepayers with the gain on the sale or transfer of utility properties, the majority rejected the notion that appreciation in the value of property automatically flows to investors. It reasoned that this theory may have had some validity when utility assets were valued at reproduction rather than original cost, but since investors are not entitled to receive a return on the *fair market value* of an asset, they should not be automatically entitled to the gain on the sale of the asset:

> If investors in a public utility possessed an indefeasible right to the appreciation in value of the utility's operating assets, the base on which their rate of return is computed--the aggregate of the assets themselves--could be set only at the true value of the assets at the moment of setting. Fairness would suggest that result and due process

> would compel it. But it is clear that the utility is not entitled of right to have its rate base established at the value which the assets would command on the current market, although that market value exceeds its original cost. This can mean only that the investors' legally protected interest in such assets does not inexorably extend to the increment in value.

Democratic Central, 485 F.2d at 802.

The Democratic Central court also concluded that ratepayers are not automatically entitled to the gain simply because they use the service furnished by the utility. Rather, the court concluded that investors and consumers "start off on an equal footing, and the disposition of the growth [in value] must depend on other factors." *Id.* at 805-806. Two principles, according to the court, should guide the disposition of the value from the sale of utility assets:

> One is the principle that the right to capital gains on utility assets is tied to the risk of capital losses. The other is the principle that he who bears the financial burden of particular utility activity should also reap the benefit resulting therefrom.

Id. at 806. In this case, the court noted that the first test was inapplicable because there was never "any risk of financial loss, actual or foreseeable, on the parcels of land which concern us here." On the second principle, however, the court held that ratepayers had borne the economic burden of the utility activities associated with the land. It found that the land in question had been in rate base and that ratepayers had paid the maintenance on such properties. It also noted that ratepayers had paid the cost of converting the properties from a street car system to a bus system.

In holding that ratepayers should be credited with the gain on the sale of the properties, the court rejected the transit commission's position that capital gains on nondepreciable assets go only to investors. The transit commission had argued that its position was consistent with its accounting practice, but the court rejected this as a reasoned basis for the distinction:

> Accounting procedures are not self-justifying; like other regulatory action of the Commission, they must reflect a rational allocation of economic rights and responsibilities between a utility's investors and consumers. The simple fact that an agency treats an item a certain way for purposes of uniform system of accounts does not mark the end of judicial scrutiny; on the contrary, a reviewing court must assure itself that the accounting practice prescribed is consistent with underlying substantive principles of public utility law. To permit an accounting device to dictate the rule of law is to allow the tail to wag the dog.

Id. at 819-820.

The court concluded that because ratepayers had shouldered the economic burdens associated with the properties, they should receive all of the gains from the sale of the properties:

> This court has never adopted the Commission's position that capital gains on nondepreciable assets inure to investors only. We decline to adopt that position now. Our historical analysis of the interests of investors in value-appreciations of operating utility assets demonstrates beyond a doubt that the burden of safeguarding the utility's investment in all of its assets--depreciable and nondepreciable--is legally assigned in its entirety to consumers.

Id. at 821.

2. Cases in Maine and Other Jurisdictions

In *Casco Bay Lines v. Public Utilities Commission*, 390 A.2d 483 (Me. 1978), the Law Court affirmed the Commission's 90% allocation to ratepayers and 10% allocation to shareholders of the gain on the sale of three vessels. The Commission spread the net gain over a period of 3 years. Although it acknowledged that ratepayers should primarily receive the benefits from the sale of depreciable assets, the Commission concluded that shareholders should retain 10% of the gain in order to maintain an incentive for the utility to achieve the best possible purchase price. The Law Court affirmed the Commission's decision, stating:

> It is entirely reasonable to redistribute those excessive depreciation payments back to the ratepayers by means of future reductions in Casco's depreciation expense.
>
> Furthermore, we note that when a utility sells property at a loss it is generally allowed to amortize such loss as an expense to be recovered from its ratepayers. It is only equitable that ratepayers who bear the cost of depreciation and maintenance on the property should be entitled to benefit from the sale of such property at a gain.

Id. at 489 - 490 (citations omitted).

In *Maine Water Co. v. PUC*, 482 A.2d 443 (Me. 1984), the Law Court determined that the gain on the sale of one division of a water company may not be flowed through to benefit the other divisions of the company, because the remaining ratepayers had paid rates based on the cost of serving divisions other than the one sold. In dicta, distinguishing between the sale of depreciable and nondepreciable utility property, the Court indicated its view that shareholders, not ratepayers, should receive the benefit of gain on the sale of nondepreciable property such as land. *Id.* at 448. Although the Law Court characterized the *Democratic Central* case as "out-of-the-ordinary," it nevertheless adhered to the D.C. Circuit's risk-of-loss/economic burden analysis. The different outcome can be explained by the holding of the case. Because none of the divisions shared a common source of water supply or any physical interconnection and because the Commission set rates for each division determined by that division's particular cost of service, the ratepayers in the remaining divisions had not contributed to the costs associated with the property sold. Nor had the ratepayers borne the risk of loss on these properties. Thus, the holding of the case is consistent with the principles of *Democratic Central*.

The dicta in *Maine Water*, distinguishing depreciable and nondepreciable property, is difficult to reconcile with the practical application of utility rate regulation. The Law Court theorized that ratepayers are not entitled to the gain on the sale of nondepreciable utility property because they do not bear the risk of loss on such property. As discussed below, we conclude that ratepayers *do* bear the risk of loss on utility investments (absent a finding of imprudence) whether such investments are in depreciable or nondepreciable assets.

Since *Maine Water*, several courts and public utility commissions have determined that ratepayers are entitled to the gain on nondepreciable property. *See*, *e.g., Midland Cogeneration Venture Limited Partnership v. Public Service Commission*, 501 N.W.2d 573, 588 (Mich.App. 1993) (affirming the Michigan Public Service Commission's decision to amortize the gas portion of the gain from the sale of pension assets over a 5-year period on the grounds that ratepayers had acquired a protectible interest in the utility's capital gains on the assets where ratepayers had funded the utility's pension programs through past rates); *Nevada Power Company v. Public Service Commission*, 779 P.2d 531 (Nev. 1989) (affirming the Nevada Public Service Commission's decision to amortize the gain from the sale of land and the utility's headquarters over a 3-year period, thus benefiting ratepayers by lowering rates while allowing shareholders to benefit from the use of the money); *Re Boston Gas*, 174 PUR 4th 200, 262 (Mass. DPU 1996) (concluding that a 5-year amortization of the gain on the sale of utility land is appropriate and consistent with the Department's long-standing policy to require the entire gain on the sale of utility property to go to ratepayers); *Re Boston Gas*, 49 PUR 4th 1, 26, 27 (finding the fact that land is nondepreciable because its useful value is not ordinarily diminished is is irrelevant to the question of who is entitled to the proceeds on the sales of this land; the determinative factor in treating a gain on the sale of land above the line was that the land had been treated as an above-the-line item and included in rate base while in the company's possession); *see also, New York Telephone Company, Filing Regarding the Sale of Real Estate to NYNEX Properties Company and Petition for Approval to Normalize the Federal Income Tax Effect of the Gain on the Sales*, Case No. 29407, Order Approving Sales to an Affiliate at No Less Than $25.42 million (N.Y. PSC 1987), and *Williston Basin Interstate Pipeline Company v. F.E.R.C.*, 115 F.3rd 1042 (D.C. Cir. 1997) . *But see, Public Utilities Commission of Texas v. Gulf States Utility Company*, 809 S.W. 2d 201 (Tex. 1991) (determining that state utility commission had failed to consider all of the equities in allocating 83% of the proceeds from the sale of two generating units to ratepayers and remanding to the commission for it to consider a number of factors related to the economic burden and risk of loss considerations set forth in *Democratic Central*); *Kansas Power & Light v. State Corporation Commission*, 620 P. 2d 329 (Kan. 1981) (state commission, which had allocated all of the gain on the sale of the utility's office building to ratepayers*,* required on remand to provide an allocation method by which ratepayers and shareholders may both benefit from the gain on the sale); *Philadelphia Suburban Water Company v. Pennsylvania Public Utilities Comm'n*, 427 A.2d 1244 (Pa. 1981) (gain on sale of nondepreciable property *not purchased through the power of eminent domain* belonged to shareholders); *Boise Water Corporation v. Idaho Public Utilities Commission*, 578 P. 2d 1089 (Idaho 1978) (where land is not depreciable property, ratepayers were not the equitable owners of the property and were not entitled to the difference between book and market value of land transferred by the utility to its affiliate).[3]

3. Commission Policy on Ratepayers' Liability for Loss and Entitlement to Gain on Sale of Depreciable and Nondepreciable Utility Property

Our decisions indicate that ratepayers, not shareowners, bear the risk of loss on prudently incurred utility investments whether the item is depreciable or nondepreciable*.* For example, in requiring ratepayers to pay for the prudent costs of cancelled or abandoned plant, the Commission has not separated nondepreciable property from depreciable property. Thus, CMP ratepayers continue to pay a return on CMP's depreciable and nondepreciable investment in Maine Yankee even though the plant is no longer operational and the value of the land is likely below its original cost. Similarly, in the context of recovery of a utility's investment in the Seabrook 2 cancelled plant, we determined that utilities may recover prudent expenditures on cancelled plant as long as the resulting charges are just and reasonable. *See Re: Maine Public Service Commission, Increase in* Rates, 67 PUR 4th 101, 118 (May 10, 1985). In that case, we allowed Maine Public Service Company to amortize its prudently incurred investment in the cancelled Seabrook II nuclear plant. We did not limit the allowed recovery to only the depreciable portion of the investment. Finally, the recently enacted statutory provisions allowing utilities the opportunity to recover stranded costs do not make any distinction between depreciable and nondepreciable assets. *See* 35-A M.R.S.A. § 3208 (Supp. 1998). These examples show that ratepayers do bear the risk of loss on utility property, whether depreciable or nondepreciable, absent a finding of imprudence.

Therefore, we do not accept CMP's argument that ratepayers are like tenants in that they do not bear any risk of loss on (nondepreciable) property and therefore are not entitled to any gain on such property. Comparing the ratepayer payment of a return on ratebase to a tenant's payment of rent to a landlord, CMP

[3]In contrast to *Philadelphia Suburban and Boise Water Corporation*, which follow the theory of "equitable ownership" set forth in the *Board of Public Utility Commissioners v. New York Telephone Co.*, 271 U.S. 23, 31-32 (1926), the more modern view expressed in Democratic Central does not focus on "equitable ownership" of the asset but on who has borne the risk of loss and the economic burdens associated within the asset. We concur with the Democratic Central Court's analysis that since shareholders are not entitled to a return on the fair market value of the asset, they are not *necessarily* entitled to the appreciation in the value of the asset.

argued that just as the tenant has no right to profits on the property he or she is renting, ratepayers have no right to the profit on the sale of nondepreciable utility property used to provide service to ratepayers. The analogy breaks down, however, because ratepayers, unlike tenants, *do* bear the risk of loss on the property. For example, if a tenant were forced to find alternate accommodations because the rented premises ceased to be habitable (through no fault of the landlord or tenant), the landlord would likely be unable to continue to recover rent payments from his or her former tenant. Thus, as CMP points out, the tenant does not bear the risk of loss. In contrast, ratepayers compensate shareholders for lost investment in abandoned utility assets (absent a finding of utility imprudence) regardless of whether the assets are depreciable or nondepreciable. Therefore, ratepayers do bear the risk of loss for depreciable as well as nondepreciable assets used to provide utility service.

Because ratepayers bear the risk of loss on depreciable as well as nondepreciable property (absent a finding of imprudence), we have not generally distinguished between them in allocating the gain to ratepayers. For example, in *Standish Telephone Company, Request for Commission Approval or Determination that Approval is not Required for Transfer of Land and Building*, Docket No. 88-21, Order Approving Stipulation, the Commission approved the parties' agreement that the utility could transfer utility land and buildings to its parent company on the condition that the utility have the property appraised to determine the fair market value and that the utility file amendments to its tariffs to reduce its rates by an amount which would return the difference between fair market value and book value to its ratepayers over a period of 5 years or less. Similarly in *Camden and Rockland, Maine and Wanakah Water Companies, Re Proposed Increase in Rates*, Docket No. 93-145, the Commission approved the reduction to rate base of the proceeds of the sale of utility property (the utility's former office building), which included both depreciable and nondepreciable components. *See* also *Northern Utilities Inc. Proposed Environmental Response Cost Recovery*, Docket No. 96-678, Order Approving Stipulation at 4, 11 (Commission approved stipulation providing for ratepayer responsibility for majority of remediation costs and entitlement to gain on the sale of the remediated manufactured gas facility sites).[4]

Similarly, the gains from the sale of generation assets pursuant to restructuring are being allocated entirely to ratepayers. Nothing in the statute requiring that stranded costs be offset by the sale of generation assets distinguishes between depreciable and nondepreciable assets. *See* 35-A M.R.S.A. § 3208. In the divestiture proceedings, no such distinction has been made. *See, e.g., Bangor Hydro-Electric Company,* Plan for Divesture of Generation Assets pursuant to 35-A M.R.S.A. § 3204, Docket No. 98-114, Order (June 17, 1998) (specifically determining that the statutory definition of “generation assets” includes land).

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[4]We recognize that, in approving stipulations, we generally indicate that no precedential value attaches to any particular component of the decision. These decisions, however, reflect at least an understanding among parties to the regulatory process in Maine that the depreciable/nondepreciable distinction is not at the heart of whether ratepayers or shareholders are entitled to gain or suffer loss.

The Commission's decision in *Public Utilities Commission, Investigation into Cobbosseecontee Telephone Company and Lincolnville Telephone Company Sale of Chances in FCC Cellular Lottery,* Docket No. 91-006 (Me. 1991), does not contradict the principles we espouse here. In *Cobbosseecontee*, the Commission found that

> ratepayers in this case have not borne any risks or burdens directly associated with the acquisition, holding or sale of the cellular lottery chances. The funds used to apply for and negotiate the sale of the chances were 100% shareholder-supplied. The ratepayers were required to bear no additional risks or costs in connection with the acquisition and/or sale of chances. Ratepayers did not assume any depreciation costs associated with the chances, nor did they bear the risk of sale at a loss. Moreover, the cellular lottery chances were intangible assets that never appeared, or would appear, in the utilities' rate base, and consumers never contributed to the holding of such assets through payment of rates. The ratepayers have in fact been shielded from loss at every turn in this venture, with shareholders bearing the only tangible risks. It also bears noting that TDS, though its local exchange carriers, cannot seek recovery from its ratepayers of the payments it made to Lincolnville and Cobbosseecontee.

Id. at 4.

Thus, *Cobbosseecontee* stands for the proposition that under the risk/burden analysis of *Democratic Central*, ratepayers are entitled to share the gain only when they have assumed the risk of loss on and contributed to the asset. Because ratepayers bore no risk of loss relating to the intangible assets, which were neither depreciable nor in rate base, ratepayers were not entitled to benefit from their sale.[5]

4. <u>Application of Democratic Central Principles to the Facts of this Case.</u>

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[5]In our recent statement of policy in the Chapter 820 rulemaking, we interpreted recent statutory amendments relating to use of utility assets, including intangibles used by utility affiliates. We determined that the Legislature intended that the allocation of the value of utility assets used by affiliates should not be based on whether or not an asset is intangible (and therefore not in rate base) or tangible. We cited with approval analyses of allocation based on ratepayers' contribution to the value of the intangible. *See Public Utilities Commission, Requirements for Non-Core Utility Activities and Transactions between Affiliates*, Docket No. 97-886, Order Provisionally Adopting Rule at 41 (February 18, 1998). Thus, this more recent policy statement represents a shift away from the tangible/intangible asset distinction.

Using the risk/burden analysis set forth by *Democratic Central*, ratepayer's entitlement to the revenues from CMP's sale of its rights of way is clear. Ratepayers bear the risk of loss in value of the land in question. For example, if the land sustained environmental damage, ratepayers would continue to pay a return on the original cost of the land, not on its reduced value.[6] In addition, as discussed above, if the land were sold at a loss, ratepayers would be expected to compensate shareholders for their lost investment (absent a finding of utility imprudence) through an amortization of the loss. Since we do not distinguish between depreciable and nondepreciable property when requiring ratepayers to pay for the lost investment, we should not make that distinction when allocating the profit from the sale of a nondepreciable investment.

We further find that the only difference between the cash flow return to utility investors for depreciable and nondepreciable property is the difference in timing. Investors' return on depreciable property is composed of the return of (depreciation) and on (return on rate base) their investment. For depreciable property, the return on investment declines over the life of the asset as the undepreciated investment declines. This continues until the asset is fully depreciated, at which point investors have been fully compensated for the value of their original investment. Once the asset is fully depreciated, it is removed from rate base and ratepayers no longer pay a return of, or on, the investment. For nondepreciable property, there is no return of the original investment because the value of the asset is not expected to decline over time. However, the return on the investment continues indefinitely because the value of the asset in rate base never changes. Thus, over the life of the asset, ratepayers' contribution is independent of whether the asset is depreciable or nondepreciable. Where an asset is held for a long period of time, as is typically the case with transmission corridors, ratepayers' contribution may well exceed the purchase price.[7]

We further find that ratepayers have borne and continue to bear the economic burdens associated with the land. Maintenance costs for the transmission corridors (trimming, spraying etc.) have always been included in rates, as have taxes on this land. Moreover, the land in question has been and will continue to be in rate base.[8] Consistent with the risk/burden analysis set forth in *Democratic Central*, we conclude that ratepayers are entitled to the gain on the sale of the

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[6]Ratepayers also would likely bear the burden of paying remediation costs for which CMP is liable. *See,* e.g., *Northern Utilities Inc., Proposed Environmental Response Cost Recovery*, Docket No. 96-678, Order Approving Stipulation at 4, 11.

[7]It can be argued that nondepreciable assets such as those at issue in this case are similar to very long-term bonds wherein, as a matter of economic reality, the value is more in the stream of interest payments than in the principal.

[8]A small portion of the land at issue apparently is not included in rate base. In a compliance phase, we will determine the exact amount that should be allocated to ratepayers. Our allocation will reflect the exclusion of the amount of proceeds related to the portion of land never in rate base from the total amount of the proceeds.

easements since they bear the risk of loss on the land over which the easements are granted and because they have shouldered significant economic burdens associated with the land.

Additional support for our decision lies in the fact that the land in question generally became available to CMP either by or under the threat of eminent domain. We agree with the IECG that CMP's right to take the land necessary for use as transmission corridors and impose on the public the aesthetic and enviromental burdens that inevitably accompany these corridors is justified only by the public purpose of its utility endeavor. The public nature of these assets underscores that they were acquired and used for, as well as supported by, utility ratepayers.

We will allow 10% of the gain to be retained by shareholders as an incentive for CMP to attain the highest possible value for the sale or lease of its rights of way. This allocation is consistent with our approach in the *Casco Bay Lines* case.[9]

A. Treatment of the Gain from the Sale of the Rights of Way

The gain to which ratepayers are entitled is to be amortized over a 5-year period beginning with the year in which each transaction occurred.[10] Such an amortization is consistent with the treatment of gains on sales of land in this and other jurisdictions. Finally, amortizing the gain over a 5-year period will allow CMP to retain a portion of the gain during the ARP period.

Most of the cases involving sales of assets have amortized the gain over a period of years. *See, e.g.* Boston Gas, 174 PUR at 262 (5-year amortization found to be appropriate for gain on the sale of land); *Casco Bay Lines*, 390 A.2d at 489-490 (3 years found to be appropriate for amortization of gain on sale of depreciable assets). We believe that amortizing the gain is the most reasonable approach in this case, as well. First, transactions involving the use of a utility rights of way by a third party are often structured as license agreements or easement agreements. A license agreement typically provides for annual fees for the use of the utility property. For example, in 1994, CMP entered into a license agreement with AT&T that provides for an annual right of way use payment for AT&T's underground fiber optic cable in CMP's

[9]It is arguable that this incentive is not necessary since the possibility of a disallowance for imprudence might provide the same incentive. In addition, the Public Advocate argues that the incentive is unnecessary because there are not expected to be any similar transactions between CMP and gas pipeline companies. We agree that it is likely that the largest pipeline rights of way transactions have already occurred. However, we also are aware that there is some chance that CMP Gas will use CMP's rights of way. In addition, there may be other contexts in which CMP might sell interests in land. Thus, we do not discard the positive incentive approach taken in *Casco Bay Lines*.

[10]For the PNGTS transaction, the amortization would begin in 1998; For the Maritimes and Northeast transaction, the amortization would begin in 1999.

transmission rights of way. *Central Maine Power Company, Request for Authorization to License Operating Properly at AT&T Communications Inc*., Docket No. 94-006, Order (March 15, 1994). The same is true of CMP's arrangements with its affiliates NEON and MaineCom for the use of CMP's rights of way for the installation of fiber optic cable.[11]

We are also aware of the possible effect of any decision on this issue on a utility's incentives when it negotiates with firms seeking to use the utility right of way. In general, right of way agreements can be structured as a lease or license agreement, where the utility receives periodic payments over the life of the agreement, or a sale, where there is a single up-front payment.[12] When the agreement is structured as a license agreement or lease arrangement, the rate-effective-year annual revenues from the agreement are applied against the revenue requirement of the utility at the time of the next rate case. Thus, under a lease arrangement, stockholders receive the economic value of the transaction prior to the next rate case and ratepayers receive it thereafter. But if the gain on a sale is credited to the utility, stockholders would receive the full value of the transaction both before and after the next rate case. This approach provides the utility with a strong incentive to structure all right of way agreements as sales, not leases, even where a lease is the better solution, and would be a classic example of regulatory policy inviting utilities to make uneconomic choices. Instead, the appropriate policy is to use the same allocation of the economic benefits for both sale and lease arrangements. Whatever division between ratepayers and shareholders is appropriate, it should be identical for lease, license and easement agreements.

Finally, this treatment brings a portion of the gain from these transactions outside of the ARP structure so that the revenues are neither direct flowthroughs to ratepayers nor retained wholly by shareholders.[13] A similar treatment was allowed by the Public Utility Commission of Oregon in dealing with the disposition

[11]These transactions provide for annual fees over a period longer than 5 years. Thus, if the payments were structured to be identical to those under the license fee agreements, they would have to be amortized over a significant**ly** longer period of time. We note, however, that no party has suggested an alternate amortization period or objected to the 5-year period. In addition, as mentioned above, 5 years has previously been identified as a reasonable amortization period for transactions involving sales of land.

[12]Hybrids with an up-front payment and periodic payments are also possible.

[13]Our deferral of ice storm costs, resulted in a similar extra-ARP ratemaking treatment. *See Deferral of Ice Storm of 1998 Service Restoration Costs*, Docket No. 98-020, Order (January 15, 1998). We subsequently concluded in Docket No. 97-580 that CMP's prudently incurred, non-reimbursed Ice Storm costs should be recovered through T&D revenue requirements over a 2-year period commencing March 1, 2000. *Public Utilities Commission Investigation of Central Maine Power Company's Stranded Costs, Transmission and Distribution Utility Revenue Requirements and Rate Design*, Docket No. 97-580, Order at 95 (March 19, 1999).

of the gain from the sale of U.S. West's sale of telephone exchanges. The sale occurred while U.S. West was still under an Alternative Form of Regulation (AFOR) plan. The parties agreed that U.S. West (USWC) would reduce net intrastate rate base by an amount equal to 80 percent of the intrastate premium. Thus, USWC agreed to make a one-time $22.4 million intrastate depreciation expense accrual. The Commission noted that this net reduction in the intrastate rate base produces an alternative way of ensuring that the remaining USWC customers receive a majority of the benefits of the acquisition premium. *In the Matter of the Joint Application of US West Communications, Inc. and Telephone Utilities of Eastern Oregon, Inc.,* Attachment D to Order (May 31, 1995.) Although the rate base reduction did not immediately benefit ratepayers because of the AFOR, they benefited from the reduction when the AFOR was terminated in 1996.

The Bench Analysis suggested that the revenues could be flowed through to ratepayers under the mandated cost or Z factor provision (¶ 12) of the ARP Stipulation but did not recommend such treatment.[14] The Public Advocate agreed that these revenues could be considered exogenous under the ARP agreement. CMP asserted that the revenues could not be exogenous under paragraph 12 of the ARP agreement because paragraph 12 contains the term “costs” rather than “revenues.”[15]

For the reasons discussed above, we conclude that amortizing the ratepayer portion of the proceeds over a 5-year period represents a reasonable and balanced approach. We further note that amortizing the payments allows shareholders to receive some of the benefit of the ratepayer portion of the gain during the ARP-effective period. Thus, for example, for the PNGTS transaction, shareholders will retain approximately **[CONFIDENTIAL BEGINS**

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[14]The Bench Analysis noted that if the revenues were not amortized, they would meet the $3 million dollar threshold and that the rights of way transactions represented an extraordinary event because of the exclusive rights transferred and because of the unprecedented extraordinary demand for the use of CMP's transmission corridors by gas pipeline companies due to the current major pipeline expansion.

[15]CMP also noted that the accounting standards referenced in the ARP agreement provide for below-the-line treatment of gains and losses from the sale of land or easements. However, as CMP acknowledges, the accounting standards require a utility to book such items below the line if no other regulatory mandate is ordered. Thus, we do not look to accounting standards for guidance in ratemaking determinations. For example, when under normal accounting principles certain costs would be expensed, we have permitted utilities, in certain circumstances, to create regulatory assets so that such costs may be recovered in rates. We agree with the *Democratic Central* court that to strictly adhere to accounting principles to determine ratemaking treatment would be “to allow the tail to wag the dog.” *Democratic Central*, at 485 F.2d at 819-820.

CONFIDENTIAL ENDS] realized from the sale.[16] Similarly for the Maritimes transaction shareholders will retain approximately **[CONFIDENTIAL BEGINS CONFIDENTIAL ENDS]** realized from the sale.[17] In both cases, the carrying costs should accrue on the unamortized portion of the gain. Because we have decided to amortize the ratepayer portion of the gain over a 5-year period, we do not reach the question of whether the revenues would be exogenous under paragraph 12 of the ARP Stipulation.[18]

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[16]This amount was calculated by **[CONFIDENTIAL BEGINS**

CONFIDENTIAL ENDS]

[17]This amount was calculated by **[CONFIDENTIAL BEGINS**

CONFIDENTIAL ENDS]

[18]We note however, that under the 5-year amortization, the annual amount of revenue from the rights of way would not meet the $3 million threshold for the amounts to be flowed through to ratepayers during the ARP-effective period.

Accordingly, it is

O R D E R E D

That the gain from the sale of easements to PNGTS and Maritimes be allocated and treated for ratemaking purposes in the manner described in the body of this Order.

Dated at Augusta, Maine this 2nd day of August, 1999.

BY ORDER OF THE COMMISSION

Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
Nugent
Diamond

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of adjudicatory proceedings are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 6(N) of the Commission's Rules of Practice and Procedure (65-407 C.M.R.11) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which consideration is sought.

2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320 (1)-(4) and the Maine Rules of Civil Procedure, Rule 73 et seq.

3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320 (5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.